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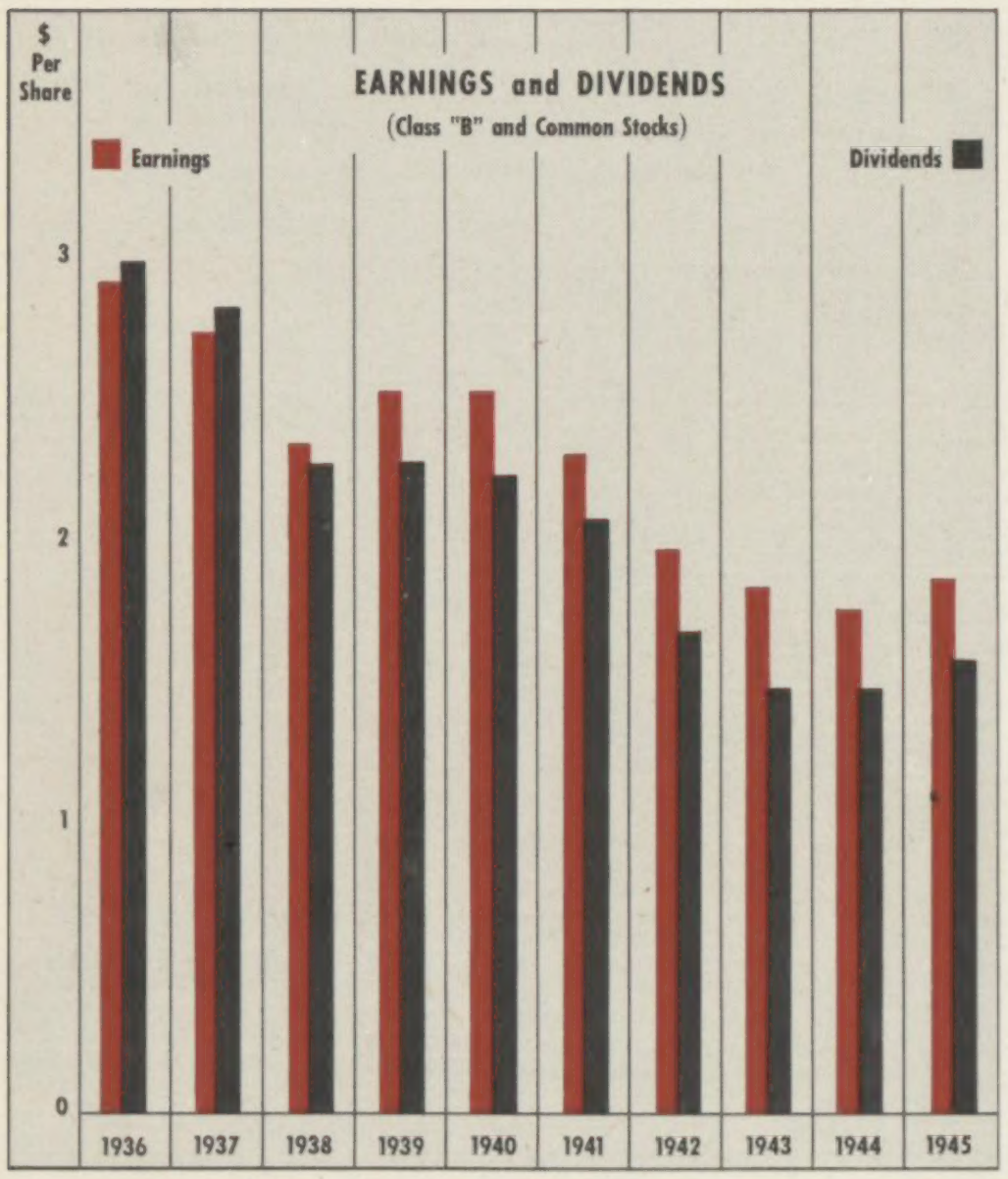
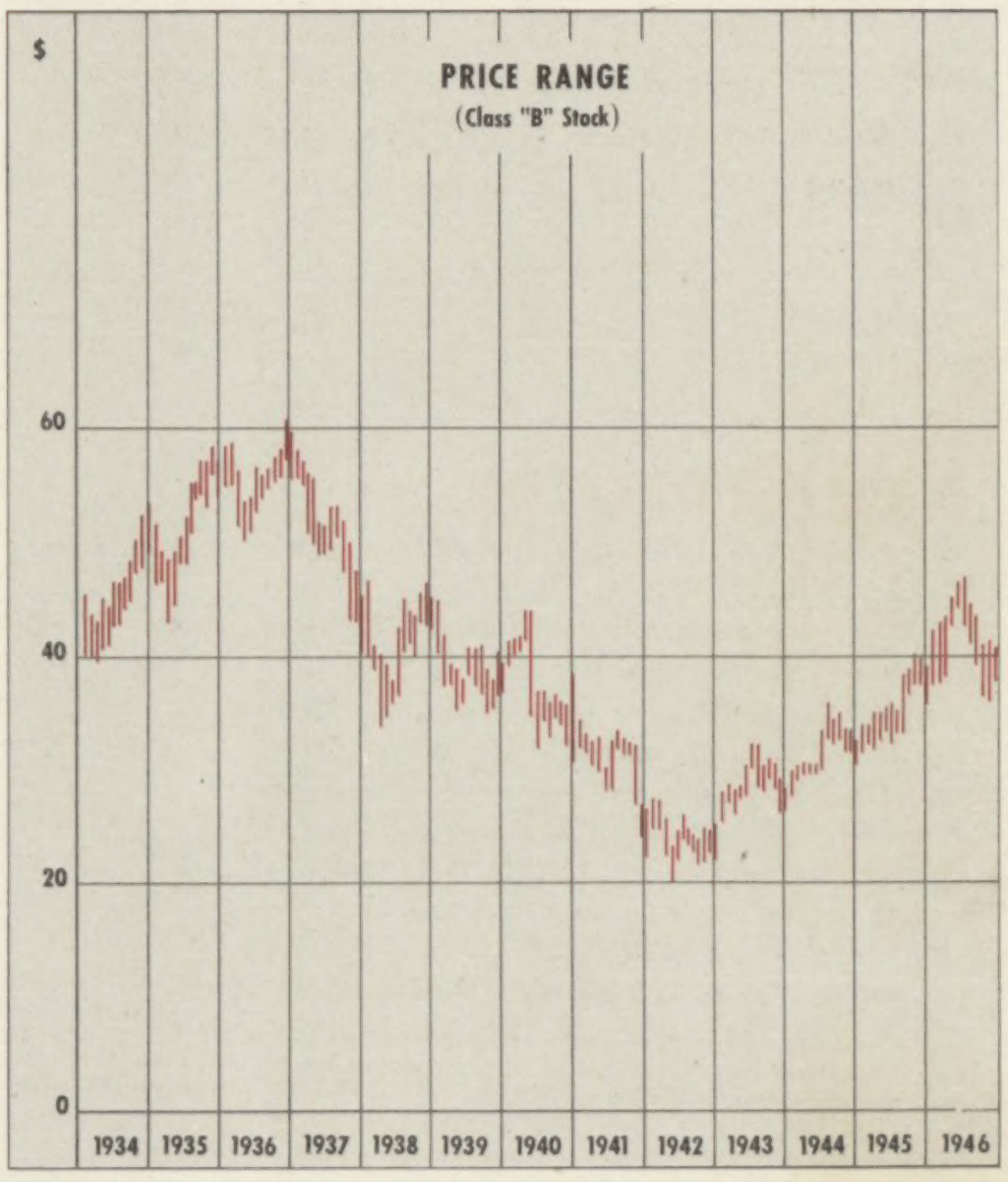
R. J. REYNOLDS TOBACCO COMPANY





TIMING . . . For every investor, sound investment procedure requires a series of separate but related decisions in each of which "risks and rewards" must be weighed. Of these decisions, all investment experience proves that "when to buy" ranks equally in importance with "what to buy." Similarly, the alert investor will recognize that there is no security which can be "bought and forgotten" and that successful investment requires keen judgment in timing sales as well as purchases.

MERRILL LYNCH, PIERCE, FENNER & BEANE

Underwriters and Distributors of Investment Securities
Brokers in Securities and Commodities

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R. J. REYNOLDS TOBACCO COMPANY

FAVORABLE

(1) The company is in a strong competitive position as a leading factor in an industry which has demonstrated stability and some growth characteristics.

(2) The war-stimulated demand for cigarettes may endure after this war as it did after World War I.

(3) The cigarette industry raised prices in 1946 for the first time in nine years. This should arrest the declining trend in profit margins.

(4) Direct labor cost a small factor in cigarette production.

UNFAVORABLE

(1) Considerable senior capital was accumulated to finance inventories at inflated prices.

(2) Loss to competitors of a part of company's former share of total cigarette market.

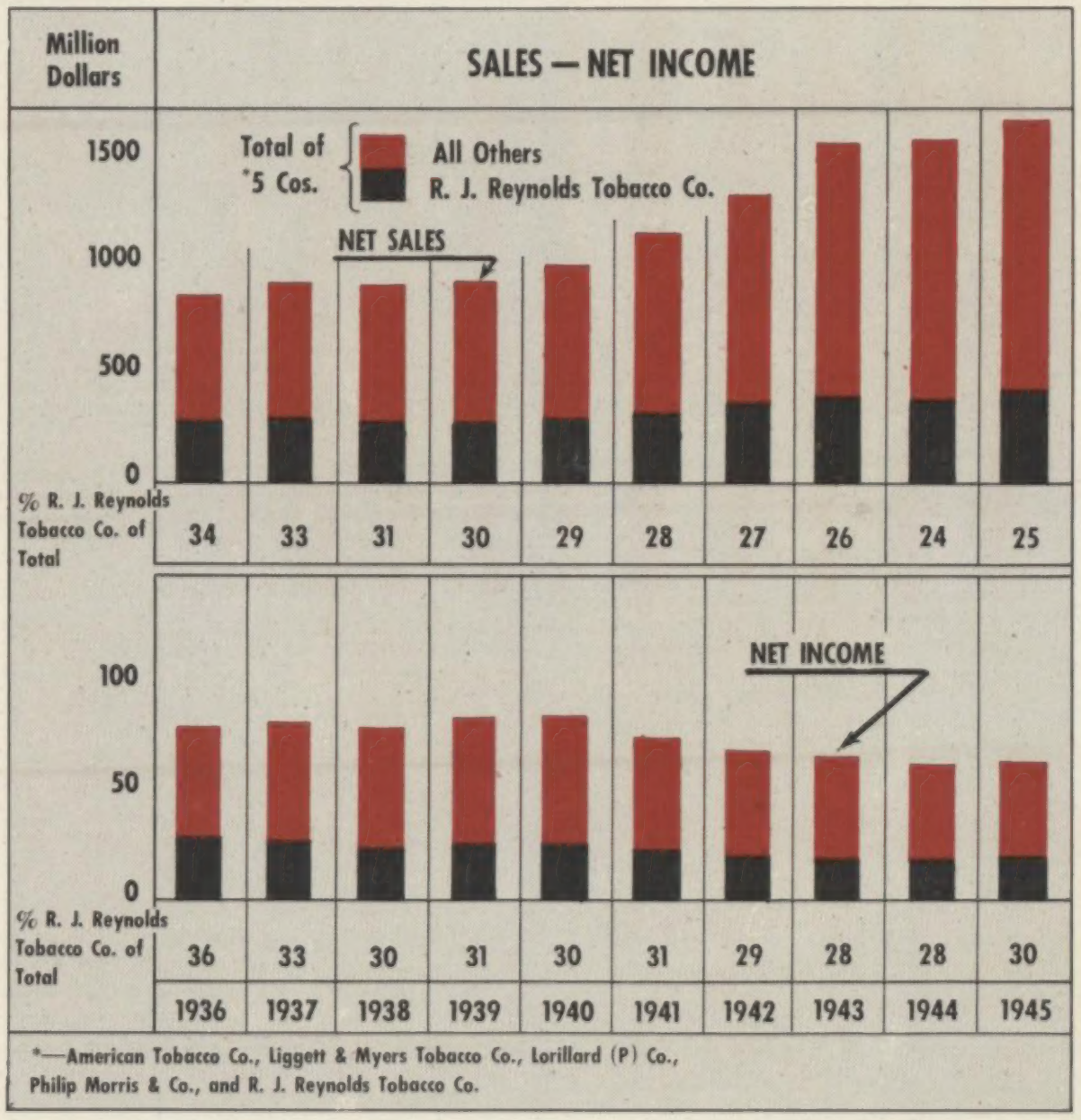
(3) Expansion of cigarette sales lacks consumption potential of large new population segment, such as women, as it did after World War I.

(4) Large number of shares of common and Class "B" outstanding have a tendency to dilute equity interest.

BASIC POSITION

Reynolds has been an industry leader since World War I, occupying either first or second place in point of sales, pre-tax profits and net profits. Of the five principal cigarette companies, Reynolds in 1945 accounted for about 25% of sales, 31% of pre-tax profits and almost 31% of net profits, standing second in the first two categories and taking equal place with another company in the third classification.

Concentration of substantially all facilities in the world's largest tobacco manufacturing plant at Winston-Salem, North Carolina, and concentration of management at the plant make this company unique in the industry in these two respects. This concentration of physical facilities and management enabled it to exercise executive direction and dictate its own policies independently even during the period 1899-1911 when the "Tobacco Trust" owned a two-thirds interest. After the dissolution of the "Trust" in 1911, founder R. J. Reynolds lost no time in putting into effect his then revolutionary ideas of a nationally advertised brand of cigarettes. CAMEL cigarettes, the only brand presently manufactured by the company, were introduced in 1913 and were an innovation at the time because they were a blend consisting preponderately of flue-cured and burley tobaccos grown entirely in the United States, but had a minor content of Maryland and imported Turkish tobaccos. In those days, brand names were transitory and manufacturers were giving away premiums and using other haphazard methods for promoting sales. The advent of the CAMEL in a handy package, and with emphasis on quality and blend, revolutionized the American cigarette industry. CAMEL packages carried the legend (and still do) "Don't look for premiums, or coupons, as the cost of the tobaccos blended in CAMEL cigarettes prohibits the use of them."



The company's products are sold in a highly competitive market and the principal brands, CAMEL cigarettes and PRINCE ALBERT smoking tobacco, are advertised extensively. In addition, Reynolds manufactures and sells GEORGE WASHINGTON, OUR ADVERTISER, STUD and other brands of smoking tobacco and about 48 brands of chewing tobacco, the more important being BROWN'S MULE, APPLE SUN CURED and DAY'S WORK.

Over 75% of the company's sales, pre-tax profits and net income can reasonably be estimated to come from CAMEL cigarettes alone. Dollar sales are divided approximately as follows: cigarettes, 87%; smoking tobacco, 8%; chewing tobacco and miscellaneous, 5%.

CAPITALIZATION—OCTOBER, 1946

2½% Debs. due 1950-1966	$60,000,000†
1¾% Serial Bank Notes due 1947-1949	6,000,000
3.6% Cum. Preferred ($100 Par)*	490,000 shares
Common ($10 Par)	1,000,000 shares
Class "B" Common ($10 Par) Non-Voting	9,000,000 shares

Preferred and Common Stocks listed on New York Stock Exchange—Symbol RJ.

*—Callable through June 30, 1948, at 103½; lower thereafter.

†—Issued to Equitable Life Assurance Society of the U. S. on October 30, 1946.

COMMENT: Capitalization has long consisted mainly of two classes of capital stock. Only infrequently has current borrowing to finance enlarged inventories been funded into long-term debt. Issuance of $49 million 3.6% preferred stock in 1945 substituted senior capital for bank borrowings to finance inventories. The senior dividend requirement ahead of the common and Class "B" stocks absorbed about 4% of earnings available for dividends on all classes of stock in 1945. The common stock commands a premium over the Class "B" stock because of its profit-sharing feature when owned by an employee.

EARNINGS

Reynolds' sales of cigarettes in 1945 reached a new peak of an estimated 70.4 billion units against 68.3 billion units reported for 1944. In common with the industry as a whole in the United States, the company has enjoyed a steadily rising trend of cigarette sales. The years 1939 to 1945, inclusive, witnessed an increase of 64% in the number of cigarette units sold, but the company's dollar sales rose only 56% in the same period. This was due to the fact that in 1944, for example, more than 25% of the cigarette units produced were sold on a tax-free basis to the United States Government. The Internal Revenue Tax amounts to $3.50 per thousand (or 47.6% of the manufacturers' present price) and with a return to civilian business, it is again included in the dollar sales figures. Average monthly sales, as reported for the nine months to September 30, 1946, amounted to $45.3 million as compared with the $35.9 million monthly average reported for the whole year 1945.

Since 1940, there has been a substantial increase in the cost of production, particularly of leaf tobaccos. The average price paid by the company for flue-cured tobacco rose from 19½¢ per pound in 1939 to 43¢ in 1944; burley tobacco, per pound, from 20.22¢ to 45.7¢. At the same time, there was no increase in the manufacturers' price of cigarettes for more than nine years until the OPA granted a general increase of 25¢ per thousand cigarettes in April, 1946. Since then, tobacco products prices have been decontrolled and all major manufacturers again raised their prices 29¢, with the exception of Reynolds which announced an increase of 26¢ per thousand cigarettes to bring the new price to $7.35. It is doubtful how much of these increases of 51¢ per thousand cigarettes will accrue in the form of net profits but per share results for the year 1946 should be considerably above those reported for 1945.

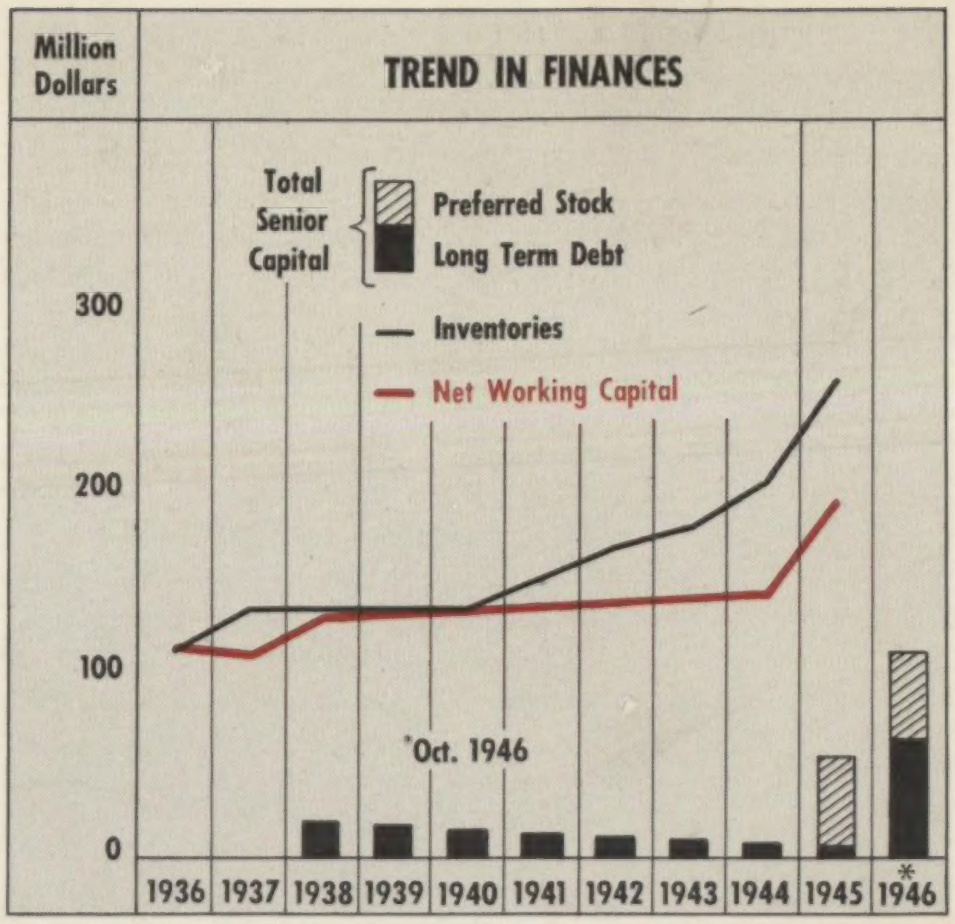
Years Ended Dec. 31	Net Sales	Deprec. & Obsoles.	Net Oper. Income	Net Oper. Margin of Profit	Fed. Inc. & Ex. Prof. Taxes	Net Income	Net Inc. % of Sales	Per Common Share: Fed. Inc. & Ex. Prof. Taxes	Earned	Divd.	Price Range Common High	Price Range Common Low	Price Range "B" High	Price Range "B" Low
	Dollar Figures in Thousands													
1946*	$547,908	$ 947	$42,647	7.8%	$15,817	$23,603	4.3%	$1.59	$2.18	$1.75‡	46⅞§	36¼§		
1945	430,967	892	35,843	8.3	13,103	19,229	4.5	1.31	1.89	1.60	40	31⅜		
1944	387,998	962	32,973	8.5	12,013	17,818†	4.6	1.20	1.78†	1.50	35⅞	28		
1943	414,264	1,041	36,757	8.9	15,701	18,563	4.5	1.57	1.86	1.50	32¼	25¼		
1942	369,212	1,072	43,902	11.9	21,492	19,860	5.4	2.15	1.99	1.70	27½	20		
1941	323,020	1,061	41,123	12.7	16,359	23,239	7.2	1.64	2.32	2.10	34¼	22⅛		
1940	292,039	1,029	36,620	12.5	8,953	25,548	8.7	0.90	2.55	2.25	44	30½		
1939	276,730	1,188	33,508	12.1	5,800	25,645	9.3	0.58	2.56	2.30	45	35		
1938	282,265	1,142	30,505	10.8	5,058	23,734	8.4	0.51	2.37	2.30	46½	33¾		
1937	302,999	1,040	35,419	11.7	5,404	27,602	9.1	0.54	2.76	2.85	58	40¼		
1936	289,313	998	36,457	12.6	6,141	29,253	10.1	0.61	2.93	3.00	60½	50		

*—Twelve months ended July 31. †—After contingency reserve equal to $0.05 per share. ‡—Full year 1946. §—Through Dec. 10.

FINANCES

Although dividend policies have been relatively liberal, the management has long maintained the company in strong financial circumstances. In the past decade, net property account decreased from $16.2 million to $15.5 million. Additions, at costs, to the property account in the past ten years amounted to $13.3 million. Net working capital rose from $117.6 million to almost $200 million, with current assets almost three times current liabilities at the end of last year. Net working capital per share of combined common stock at the end of 1945 amounted to $14.40. Since 1936, the dollar value of tobacco inventories has risen from $114.8 million to $265 million and in order to finance this large increase, the company created senior capital amounting to $49 million. At the end of 1945, $76.5 million of notes payable were included in current liabilities. In October, 1946, the company borrowed $60 million from an insurance company in a 20-year debenture loan carrying 2½% interest.

The employees' profit sharing plan provides that every person in the organization from top to bottom who has owned common stock and has been employed not less than a year is entitled to a share, in proportion to his holdings of stock, in 10% of net earnings over and above a fixed amount of $2,219,000. It is for this reason that the common stock commands a premium over the class "B" stock. Approximately 2,000 officers and employees received (in addition to regular dividends) per share distributions which amounted to an average of $2.25 in recent years.



OUTLOOK

R. J. Reynolds has enjoyed a continuity of management which dates right back to the founding of the company in 1875. Some of the reported reasons which prompted Richard Reynolds to choose a cigarette with the name CAMEL were (1) because he liked animal names; (2) because it suggested the Orient; and (3) because it was easy to pronounce. Besides creating one of the world's largest selling cigarettes, Reynolds amassed a vast fortune for himself.

Growth in cigarette consumption has been one of the marvels of the industrial age. In Europe, French and British soldiers got accustomed to cigarettes in the Crimean War and at about the same time, Confederates and Yankees learned to smoke when in or near the tobacco producing centers of Virginia and North Carolina. In 1869, tax-paid production amounted to 1.7 million cigarettes; 408.7 million in 1880; should reach 335 billion in 1946; and is now expected to total 400 billion units within the next several years if public purchasing power is sustained at a high level. History repeated itself—both World Wars greatly increased cigarette consumption, although after World War II the industry lacks the growth potential which was present after the first conflict in a large non-smoking female segment of the population.

A distinctly advantageous factor is the lack of importance of direct labor expended in the process of manufacturing cigarettes. When last reported in 1941, it amounted to $0.18 per thousand cigarettes, or 5.15% of the pre-war $3.50 manufacturers' price (before $3.50 Internal Revenue). Although the figure may have increased somewhat, it still compares very favorably with that of other manufacturing industries.

CAMEL cigarette sales, while consistently increasing in units, dropped from first to second place in 1941; and it is believed that wartime Governmental allocations of tobacco, which at times restricted Reynolds' operations to as low as 55% of capacity, may have been largely responsible for the loss of the leading sales position. The demand now still exceeds the supply and distributors are receiving shipment on allocation. At the same time, the price of CAMELS, at the wholesale level, is 3¢ per thousand below the other major brands. Profits on the large volume of business which is being anticipated will depend, to a large extent, upon the future prices for leaf tobacco, the major item in manufacturing costs. If lower leaf prices should prevail in the future, Reynolds may find itself one of the major beneficiaries in the industry by virtue of its comparatively low inventories. An effort will then undoubtedly be made to reduce the large amount of senior capital which has been accumulated.

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The firm of Merrill Lynch, Pierce, Fenner & Beane for its own account and/or its general partners on December, 17, 1946, had a small direct and indirect beneficial interest (market value less than $50,000) in the securities of this company.

The information contained in this folder has been obtained from the company reports, various statistical services and other sources that we believe reliable, but without independent verification or investigation by us. The information is not intended to, and shall not be relied upon, as comprising a complete report or analysis. Neither the facts presented nor the opinions expressed constitute representations by us.

JANUARY, 1947